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No. 59024-3-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

LAURA HOLDEN, *et al.*,

Respondents,

vs.

FARMERS INSURANCE COMPANY OF WASHINGTON, a domestic insurer; FARMERS INSURANCE EXCHANGE, a foreign insurer; and all affiliated Farmers Insurance Companies and/or entities,

Appellants.

REPLY BRIEF FOR APPELLANTS

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A. State-Mandated Policy Language Is Not Construed Against The Insurer.

The central argument in Holden's brief asserts that "[a]n ambiguous clause in an insurance policy must be construed in favor of the insured, even though the insurer may have intended a different meaning."[1] This point is critical to many of Holden's other arguments. For example, Holden argues that "[i]f Farmers wanted to exclude Washington State sales tax in its computation of ACV, all it had to do was say so in its policy."[2] Similarly, Holden devotes much of her brief to arguing about what FICW supposedly thought the policy language meant.[3] Both arguments assume that it makes some difference what FICW thought the policy language meant. Because FICW did not select that language, it makes no difference what FICW thought and the language may not be construed against FICW.

All the policy construction rules Holden cites deal with the usual situation where the insurance company chose the language to be included

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[1] Holden Br. 18.

[2] Holden Br. 26.

[3] Holden Br. 6-13.

in its policy. As FICW pointed out in its opening brief, a different rule applies where the insurer was obliged to utilize state-drafted language: "[w]here the language is imposed by law, that language is construed under the principles of statutory construction, and is not construed against the insurer."[4] Holden simply ignores this central point, showing that Holden can find no answer to it.

Because the policy language here is state-mandated, almost all of Holden's arguments are irrelevant.

B. The Supreme Court's Construction Of "Actual Cash Value" In *Solomon* Governs Here.

In *Solomon*,[5] the Supreme Court construed the term "actual cash value" to mean "fair market value." Holden argues that *Solomon* can be disregarded because *Hess*[6] overruled it.[7]

FICW has explained that *Solomon* had two holdings, only one of which was overruled by *Hess,* and the overruled holding does not matter

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[4] FICW Br. 11 (citations omitted).

[5] *National Fire Insurance Company v. Solomon*, 96 Wn.2d 763, 770, 638 P.2d 1259 (1982).

[6] *Hess v. North Pacific Insurance Co.*, 122 Wn.2d 180, 191, 859 P.2d 586 (1993).

[7] Holden Br. 21-22.

here.[8] Holden responds that the language of *Hess* limited *Solomon* "'whatever its holdings may be, to those facts and the policy involved'" in *Solomon.*[9] For the reasons previously stated, FICW submits that *Hess* intended only to limit the holding of *Solomon* regarding the time at which replacement cost payment would be due (the point governed by voluntarily selected policy language, which differed in *Hess* from that in *Solomon*). But even if *Hess* intended to limit application of *Solomon's* holding construing the term "actual cash value," that issue was not before the Court in *Hess,* so the limiting language would be mere dicta, and not authoritative.

Moreover, it does not matter whether the holding of *Solomon* survives. The DOI adopted that holding by requiring FICW to define "actual cash value" as "fair market value." That definition survives, even if *Solomon*'s does not. And it is still state-mandated language, which may not be construed against FICW.

Nothing in DOI Bulletin 89-3 alters the meaning the law would otherwise attach to the term "fair market value." Bulletin 89-3 was issued in response to assertion by a Seattle law firm the Insurance Commissioner

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[8] FICW Br. 12-13.

[9] Holden Br. 21, *quoting Hess,* 122 Wn.2d at 191.

"'supports the view that sales tax should not be paid in an ACV loss' except with respect to the settlement of first-party automobile total losses."[10] The Bulletin made clear that the Commissioner did not support that view, but also refrained from adopting the opposite view (the one Holden now espouses). The Commissioner simply declared that "[a]n insurer must deal with taxes ... in good faith."[11]

When Holden complained to the DOI about FICW's refusal to pay sales tax on her claim, DOI took no action on her complaint.[12] That might be interpreted to support FICW's position. At worst, it confirms the conclusion that Bulletin 89-3 took no position on the issue Holden now presents.

C. Sales Tax Is Not Part Of An Insured's ACV Loss.

FICW agrees with Holden that the purpose of ACV coverage is indemnity: "to place the [insured] in the same position as she was in prior to the property damage -- not in a better or worse position."[13] But an ACV settlement will ordinarily be less than what is available under the more

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[10] Holden Br. 24, *quoting* Bulletin 89-3.

[11] Bulletin 89-3, *quoted* Holden Br. 24.

[12] FICW Br. 8-9.

[13] Holden Br. 29.

expensive replacement cost coverage. While an ACV settlement (calculated as FICW proposes) did not enable Holden to purchase a replacement for the damage property, it did place her in the same position as she would have been had she sold the property in undamaged condition: she received the property's fair market value, just as the policy requires. As a seller, she would never have received sales tax, so she need not receive that to be made whole.

Holden refuses to accept the implications of the "fair market value" definition of ACV, continually seeking to equate ACV with "replacement cost less depreciation."[14] As FICW has explained, replacement cost less depreciation is one way to approximate fair market value.[15] While sales tax can be viewed as part of replacement cost, that does not require similar inclusion when replacement cost is used as a starting point for approximating the value of used property.

FICW distinguished *Ghoman v. New Hampshire Insurance Company*,[16] because *Ghoman* defined ACV as "replacement cost, less

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[14] Holden Br. 5, 7-8, 11, 15-17, 20, 23, 26-27.

[15] FICW Br. 10 n.17.l

[16] *Ghoman v. New Hampshire Insurance Company*, 159 F. Supp. 2d 928 (N.D. Tex. 2001)

depreciation."[17] Holden responds by quoting the prior paragraph of *Ghoman,* where the *Ghoman* court states that '[u]nder Texas law, the term 'actual cash value' is synonymous with 'fair market value.'"[18] But the language Holden cites was only preliminary. The language FICW cites was the court's stated conclusion on which it based the remainder of its reasoning. And the argument before the court addressed concerned the effect on insurance adjustment of the fact that the insured had not yet incurred the costs proposed to be included in the ACV adjustment.[19] That is not the argument made here.

Holden seeks to distinguish *State Farm Mutual Automobile*

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[17] *Id.* at 934.

[18] *Id.,* quoted Holden Br. 22. Actually, both of the quotes misstate Texas law, which follows the "broad evidence rule":

> The courts have not abandoned the consideration of either market or reproduction or replacement values in arriving at actual value to the insured, but evidence of these values may be used as a guide in making that determination rather than a shackle which compels strict adherence thereto. The trier of facts may consider original cost and cost of replacement, the opinions upon value given by qualified witnesses, the gainful uses to which the property has been put as well as any other facts reasonably tending to shed light on the subject.

Crisp v. Security National Insurance Company, 369 S.W.2d 326, 328 (Tex. 1963).

[19] *Id.* at 934-35.

Insurance Company v. Berthelot[20] on two grounds.[21] One of these is the ambiguity argument already disposed of. Additionally, she notes that *Berthelot* was an auto case and WAC 284-30-390(1) mandates payment of sales tax under auto policies.[22] But this case, like *Berthelot,* does not involve a Washington auto policy, so WAC 284-30-390(1) is equally inapplicable in both cases. Auto policies are governed by a different statute, and WAC 284-30-390(1) applies only to such policies. Extending that regulation to the fire policy here would usurp the Commissioner's quasi-legislative power.

In the end, neither *Berthelot* nor *Ghoman* is more than persuasive authority. But Washington law is clear both on the meaning of "fair market value" and on the fact that "fair market value" does not include sales tax.[23] Those rules apply here.

D. Even If Relevant, FICW's Practices Concerning Payment Of Sales Tax Offer No Support For Payment To Holden.

Holden relies heavily on testimony and documents concerning

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[20] *State Farm Mutual Automobile Insurance Company v. Berthelot*, 732 So.2d 1230, 1235-37 (La. 1999).

[21] Holden Br. 30-32.

[22] Holden Br. 30-32.

[23] FICW Br. 14.

FICW's understanding of the policy language here and practices concerning payment of sales tax, in an effort to create an ambiguity not found in the policy language (even disregarding the binding construction of that language by the Supreme Court).[24] As explained, at Sec. A, *supra,* FICW's understanding and interpretation are irrelevant when construing state-mandated language.

But even if FICW's understanding and practices were relevant, Holden's argument depends on a distorted view of the evidence. For example, Holden quotes the deposition testimony of Robert Hower to show a purported ambiguity by implying a purported "internal dialogue" about payment of sales tax on ACV claims.[25] But Mr. Hower clearly and repeatedly testified that FICW does not pay sales tax (and had not paid it for as long as he can remember) where, as here, the lost or damaged items have not been replaced. Indeed, Mr. Hower repeated this ***over 30 times*** throughout this deposition.[26] Even Holden's counsel conceded that

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[24] Holden Br. 6-13.

[25] Holden Br. 7-10.

[26] CP447:23 to 448:3; CP449:22-24; CP450:23 to 451:11; CP452: 20-21; CP453:5-9; CP454:4-8; CP455:25 to 456:2; CP456:11-16; CP456:11-16; CP456:23 to 457:1; CP458:18-20; CP460:10 to 461:4; CP462:14-15; CP463:3-7; CP463:18-22; CP464:10-13; CP464:20-24; CP465:15-21; CP466:3-9; CP467:24 to 468: 3; CP469:9-14; CP470:10-17; CP483:7-9; (footnote continued on next page)

FICW's practice in this regard was "crystal clear."[27]

Holden also cites to various documents that she claims evidence some internal confusion regarding whether sales tax should be paid on ACV claims. A closer review of these documents, however, reveals no such confusion.

First, Holden cites to the Washington Claims Handling Guidelines, which states "[o]n ACV policies, we owe taxes up front."[28] Holden ignores, however, Mr. Hower's testimony that this statement is a misprint; the words "do not" should have been included, so that the phrase reads "we ***do not*** owe taxes up front," which is consistent with FICW's policy.[29] Indeed, the document itself makes clear that sales tax is not owed on ACV settlements unless and until the item(s) is replaced "...taxes are ***not***

(footnote continued from previous page)
CP484:13-16; CP485:12-15; CP485:23-25; CP486:9-12; CP486:22 to 487:10; CP488:16-17; CP488:21-24; CP489:12-14; CP489:22-24; CP490:3-7; CP492:5-8. At CP141 (condensed transcript 73:18 to 74:10), Mr. Hower testified that the value of a brand new toaster would include sales tax. But he later clarified this by testifying that "in order to receive the sales tax, you have to replace the item." CP449:22-24.

[27] CP469:22.

[28] CP199, quoted at Holden Br. 10.

[29] CP460:16 ("Apparently, it's a misprint.").

included in the ACV payment";[30] "On ACV policies we ***do not*** owe tax up front. If the depreciation is recoverable, we pay the taxes once the items are replaced";[31] "taxes are ***not*** included in the ACV payment."[32]

Next, Holden cites three internal memos that affirm FICW's policy regarding sales tax.[33] Indeed, the first of these, a memo regarding Mark Cole's Property Insurance Law report, states that the report "supports [FICW's] position regarding sales tax and ACV payments."[34] The Cole report, which was published in 1989 and distributed to FICW employees that same year, explains that "[t]here are several good reasons for not including sales tax in actual cash value calculations."[35] This is consistent with Mr. Hower's testimony that FICW has not paid sales tax on ACV settlements for as long as he can recall.[36]

The second internal memo states that "sales tax should be included

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[30] CP194 (emphasis added).

[31] CP195 (emphasis added).

[32] CP199 (emphasis added).

[33] *See* Holden Br. 10; CP192; CP205; CP207.

[34] CP192.

[35] CP 496.

[36] CP464:14-24.

on an ACV settlement if the policy does not include a replacement cost endorsement."[37] This is fully consistent with FICW's practice, as explained by Mr. Hower, of paying sales tax on an ACV-only policy if the insured actually replaces the property and incurs such tax.

The third internal memo states that "sales tax is paid up front ONLY on the Protector Plus policy."[38] Again, this is consistent with FICW's long-standing policy of paying sales tax only when incurred. The Protector Plus was excepted from this practice because, at the time the memo was issued, it provided for full replacement coverage up front. It is undisputed that Holden did not have a Protector Plus policy.

Holden further relies on various generalized manuals used throughout Farmers to imply that FICW uses the replacement cost, less depreciation method, to the exclusion of all other methods, to determine ACV.[39] But, as Mr. Hower repeatedly explained, these manuals are mere guidelines used in nationwide training, are not specific to Washington, and do not dictate FICW's claims handling practices in Washington.[40]

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[37] CP205.

[38] CP207, quoted at Holden Br. 10.

[39] CP209-211, CP213-14, CP216-18, quoted at Holden Br. 10-11.

[40] CP479:3-15; CP480:1-20.

Mr. Hower further testified that FICW adjusters receive extensive Washington-specific training, where they learn the various methods to determine ACV and that sales tax is not included in the ACV calculation.[41]

Finally, Holden cites a single email string from one adjuster, Greg Ehrlich,[42] questioning FICW's practice concerning sales tax on partial building losses (which are not at issue in this litigation). Although Mr. Ehrlich refers to a "change in policy," Mr. Hower's testimony confirms there had been no change in FICW's policy regarding the payment of sales tax on ACV settlements. In fact, in response to Mr. Ehrlich's statement, Mr. Hower wrote "what has changed?" Mr. Ehrlich also states that FICW's policy is inconsistent with the position advocated by the Property Loss Research Bureau ("PLRB"). To the contrary, on July 28, 1997 the PLRB issued an opinion addressing the issue of whether an insurer in Washington must pay for anticipated sales tax in addition to actual cash value for lost contents before the contents have been replaced.[43] The response was an unequivocal "No." *Id.* The opinion went

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[41] CP459:11-19; CP478:3-14.

[42] CP220, quoted at Holden Br. 11.

[43] CP287-288.

on:

> In Washington, actual cash value equals fair market value. None of the case law from Washington suggests that fair market value includes sales tax. Sales tax is more likely a portion of a replacement cost recovery.

In short, the purported "internal dialogue" and confusion referenced in Respondent's brief is non-existent and does not refute or even place in question the consistency of FICW's practice. None of the statements were disclosed to Holden or (so far as the record shows) any other insured before they purchased their policies, so there could have been no reliance on those statements. Stray errors in internal memoranda or adjuster practices do not bind FICW to continue those errors in handling future claims.

E. Holden Is Not Entitled To Attorneys' Fees.

Holden's request for attorneys' fees should be denied. *Olympic Steamship Company, Inc. v. Centennial Insurance Company*,[44] is inapplicable because FICW does not dispute coverage; rather this case presents a dispute over the value of Holden's claim.[45] Holden fails to

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[44] *Olympic Steamship Company, Inc. v. Centennial Insurance Company*, 117 Wn.2d 37, 811 P.2d 673 (1991).

[45] *Dayton v. Farmers Insurance Group*, 124 Wn.2d 277, 280, 876 P.2d 896 (1994) ("Coverage is not an issue; Farmers accepted coverage. ...
(footnote continued on next page)

offer any basis for application of *Olympic Steamship*. Further, the "rule regarding attorney fees on appeal requires more than a bald request for such fees."[46] It is insufficient for Holden to merely cite to RAP 18.1 as a basis for attorneys' fees on appeal.[47]

II. CONCLUSION

Based on the foregoing and on its opening brief, FICW respectfully requests that this Court reverse the summary judgment granted to Holden and enter or direct the Superior Court to enter summary judgment for FICW.

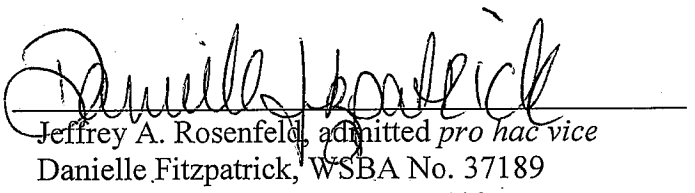
(footnote continued from previous page)
Instead, this case presents a dispute over ***the value of the claim*** presented under the policy. Such disputes are ***not*** properly governed by the rule in *Olympic Steamship*.") (emphasis added); *Mailloux v. State Farm Mut. Auto. Ins. Co.*, 76 Wn. App. 507, 517, 887 P.2d 449 (1995) ("*Olympic Steamship* does not authorize reasonable attorneys fees when an insurer denies a claim but not coverage.").

[46] *Grundy v. Brack Family Trust*, 116 Wn. App. 625, 636, 67 P.3d 500 (2003), *rev'd on other grounds*, 155 Wn.2d 1, 117 P.3d 1089 (2005).

[47] *Johnson v. Cash Store*, 116 Wn. App. 833, 851, 68 P.3d 1099 (2003) ("Mere inclusion of a request for fees and costs in the last line of the conclusion in a brief is not sufficient under RAP 18.1(b)."); *Erwin v. Roundup Corp.*, 110 Wn. App. 308, 317, 40 P.3d 675 (2002) ("RAP 18.1(b) requires a party to devote a section of its brief to the request for fees. This requires more than a simple request for attorneys fees on appeal.").

RESPECTFULLY SUBMITTED this 4th day of September, 2007.

DLA PIPER US LLP



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CERTIFICATE OF SERVICE

I hereby certify that on the 4th day of September, 2007, I caused to be served a true and complete copy of the foregoing **REPLY BRIEF FOR APPELLANTS** on counsel of record at the address and in the manner shown below:

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